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Pension system to go with smaller reserve

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SALEM -- The board of Oregon's public employee pension system is redistributing its reserves, which will reduce the payments due from state government, cities, counties and school districts.

The decision will save Oregon's public sector more than $100 million a year starting in 2007, the Public Employees Retirement System board said. The board will meet March 31 to take final action. It voted 3-2 in favor of the idea late last month.

The majority on the board and staff members said the system's finances have stabilized after a round of reforms in 2003 and two Oregon Supreme Court rulings in 2005 on challenges to those reforms.

The board voted to shrink its all-purpose contingency reserve from $1.4 billion to $250 million and to empty its $450 million capital-preservation reserve.

Some money will be shifted into a third reserve as insurance in case pension system investments don't earn enough to pay the 8 percent annual increase guaranteed for longtime workers' pension accounts. That reserve will grow from $311 million to $968 million, said Dale Orr, a finance manager for the pension system.

The decision reflects renewed health in the pension system.

In 2003, the long-term shortfall between pension resources and obligations stood at $14.8 billion. Bill Hallmark, Public Employees Retirement System actuary, said this week that reforms, a stronger stock market and the reserves decision will help reduce the shortfall to $4.4 billion, with the potential for a further reduction as a result of last year's investment returns.

Orr said the exact rates for employer contributions next year haven't been set, and they could be reduced further if the board adopts proposals to change the way it calculates benefit costs and to spread investment gains and losses across more years.

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Taxpayers may face big blow for pensions

Riordan joins alarm chorus

By Troy Anderson, Staff Writer
LA Daily News

Already facing deficits of more than $110 billion, public-employee pension plans in Los Angeles and elsewhere in the state have overestimated future investment income in a move that could imperil the systems and require taxpayer bailouts, former Mayor Richard Riordan and other financial experts warn.

Pension systems in California are operating on assumptions of a 7.5 percent to 8.5 percent annual return on investment portfolios, but investment experts say historical trends suggest stocks will increase by only 6 percent to 7 percent annually.

Coupled with rising retirement rates and growing pension benefits, the resulting squeeze could leave dozens of pension funds without enough money for payouts.

"I'm worried about the whole state," Riordan, who worked with Los Angeles-based Rubalcava Capital Management in reviewing pension systems, said Thursday.

"I think the clear thing is that L.A. is better off than the vast majority of cities in California. ... However, (Los Angeles officials) are going to have to revisit their assumptions on annual returns sooner rather than later. ... There are big problems ahead, and they should be tackled right now."

Los Angeles city and county officials defend their pension systems, saying they are in far better condition than those in Orange County and San Diego, where unfunded liabilities are threatening to bankrupt those jurisdictions.

And Los Angeles City Administrative Officer William Fujioka said city officials met with Alex Rubalcava, president of Rubalcava Capital Management, and found some "very significant errors in his estimates and assumptions."

"There was a comparison of us to San Diego," Fujioka said. "I take strong exception to that. The city of Los Angeles has done an exceptional job in managing our retirement benefits. Unlike other major cities throughout California, we have not raised our benefits for city employees."

Still, Rubalcava and other financial experts say that if the price-to-earnings ratio for Standard & Poor's 500 falls from its current 19 to its historical median of 15 - which some top financial experts expect - pension plans such as Los Angeles' could require rising contribution rates from taxpayers.

Such a scenario would only add to the state's already massive unfunded liabilities for pensions and retiree health benefits - estimated at a combined $150 billion to $190 billion - and to the amount taxpayers would have to contribute to keep the systems solvent.

Riordan and other financial experts plan to address the issue at an upcoming Los Angeles Area Chamber of Commerce luncheon.

Ron Gastelum, executive vice president of the chamber, said he hopes the income assumptions that pension system administrators have made are correct because the funds already are taking a growing amount of taxpayer money.

"However, credible economists and investors, such as Warren Buffett, and community leaders like former Mayor Dick Riordan are suggesting that these assumptions may not be prudent, and given the amount of money involved and the expectations of pensioners, it bears a fresh look," Gastelum said.

The warning comes atop City Controller Laura Chick's announcement earlier this week that she will audit the city's pension systems.

But Chick spokesman Rob Wilcox said the information Riordan and financial experts used in reviewing the systems is "based on faulty assumptions which are largely disputed.

"However, this is why the City Charter requires a top-to-bottom audit of our pension systems, which we are in the process of starting," Wilcox said. "Working with the mayor and City Council, we will disclose and correct any problems found."

Rubalcava said he's not trying to predict how stock markets will perform, but is concerned about pension deficits. Dialogue should be opened with elected officials and pension system administrators, he said.

He also noted that some pension plans haven't met their investment-return projections in recent years.

For instance, the Los Angeles City Employees Retirement System is only 73 percent funded and has a $2.95 billion unfunded liability. It had a 4.4 percent return over the past five years, but bases annual contributions from taxpayers on the assumption of an 8 percent return.

But LACERS General Manager Robert Aguallo said the $9.4 billion fund's 10-year investment-return performance is 9.9 percent, and he stands by the assumptions.

"Clearly, Mr. Rubalcava has a different opinion than our experts," Aguallo said. "In the pension world, we typically use a wide spectrum of years when looking at our performance. We look at one, three, five and 10 years."

Rubalcava said the 10-year performance measure is not a good one because it includes 1995 through 2000 - when the stock market was overvalued.

The Los Angeles Fire & Police Pensions system had a 5.25 percent return over the past five years, is 90 percent funded and has an unfunded liability of $1.4 billion. It bases annual contributions from taxpayers on an 8.5 percent investment-return assumption.

Even if the fund meets that 8.5 percent assumption in the years to come, the taxpayer contribution still will rise from $323 million annually to $339 million in 2009. But if the fund returns only 5 percent, the contribution will rise from $330 million to $423 million in 2009, according to a fund report.

General Manager Michael A. Perez pointed out that the $13.5 billion fund returned 9.24 percent over 10 years and 10.52 percent over 20 years.

"Our actuary comes up with our interest-rate assumption, as well as two other economic assumptions, and the board goes through a thorough review process to adopt these assumptions," Perez said.

The Los Angeles County Employees Retirement Association had a 3.7 percent return over the past five years, is 86 percent funded and has an unfunded liability of $4.9 billion. It bases annual contributions on a 7.75 percent investment income assumption.

LACERA Assistant Executive Officer Gregg Rademacher said the $32 billion fund returned 9.5 percent over the past decade.

"We're a long-term investor," Rademacher said. "We believe our long-term assumption of 7.75 percent is appropriate, understanding that in the short term we may do better than 7.75 percent and in some years we may do less than 7.75 percent."

Troy Anderson, (213) 974-8985

troy.anderson@dailynews.com

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perspective

A 3 percent solution for PERA

Rescue plan for retirement group's finances might be simple

By Bob Ewegen
Deputy Editorial Page Editor
DenverPost.com

The Colorado legislature has been wrestling with several complex plans to plug a supposed $12.8 billion gap in the state's Public Employee Retirement Association finances. Now, key political players are talking about a rescue plan so simple that it could be dubbed "the 3 percent solution."

As outlined by Sen. Dave Owen, R-Greeley, the fix would earmark 1 percent of the pay increase granted state employees for each of the three fiscal years starting July 1, 2007 to a fund designed to buttress PERA. Thus, after 2009, 3 percent of each employee's pay would go to bolster PERA finances - raising the employee contribution from its current 8 percent to 11 percent.

Owen's 3 percent solution was foreshadowed by Senate Bill 162, a bill he introduced with the backing of the governor that outlines a long and complicated set of changes for PERA. The changes include establishing a "two-tier" pension plan that would pay employees hired after Jan. 1, 2007, retirement benefits averaging about 19 percent less than those enjoyed by current employees and retirees. In addition, employer contributions to the pension fund, now 10.15 percent of the employee salaries, would rise 3 percent to 13.15 percent by 2012, as already required by a 2005 law.

As introduced, the 3 percent solution would apply only to state employees. But Owen told The Denver Post that extending the same formula to school and municipal employees would allow eliminating most of the benefit cuts aimed at new "second tier" employees.

State Treasurer Mark Hillman confirms Owen's math. "Each 1 percent of PERA-covered payroll equals about $56 million," Hillman told The Post. "So by 2010, you'd have $168 million a year in 'new money' going to PERA. And $168 million a year invested at 6 percent equals $13.8 billion in 30 years."

By itself, the 3 percent solution could generate enough money to cover PERA's long-term funding shortfall. That fact, coupled with the plan's simplicity, makes it attractive to legislators struggling to craft a PERA bailout bill.

The fact that any kind of PERA reform is necessary at all would have startled lawmakers as recently as six years ago. In 2000, PERA reserves were considered more than ample to cover all of its future obligations. Buoyed by those robust projections, the legislature in the 1990s boosted retirees' benefits and dropped the minimum retirement age for full benefits to 50.

The benefit increases pleased the 378,454 PERA members, including 71,088 retirees now receiving benefits. That number includes state employees as well as employees of all the state's school districts except Denver. Additionally, some cities and one county, Boulder, are in PERA.

Those benefit increases seemed affordable at the time. But the stock market plunge that started in 2000 leftPERA with just 73 cents invested to cover each dollar in future obligations. PERA suffered a startling reversal of fortune in just six years - on paper, anyway. But the fund's problems don't add up to a crisis.

First of all, these dire numbers, like their rosy predecessors, are just projections - educated guesses, really - of what various experts think PERA's investments will earn over the next 30 years, coupled with similar guesses as to how many employees will retire, and at what ages, over that same period.

It does no disservice to the various actuaries who are now guessing that PERA is $12.8 billion short of meeting its long-term obligations to note that just six years ago the plan had a modest surplus. As far as hard numbers go, PERA's current portfolio is valued at $35 billion - a very solid base upon which to build.

None of these caveats demonstrate that public employees and taxpayers alike shouldn't act top secure PERA's future. PERA officials strongly believe that prudence dictates taking corrective steps soon - not because the fund faces an immediate crisis but because relatively small reforms now will produce major changes over 30 years.

"The margin for error is very, very slim," PERA executive director Meredith Williams said after the agency's board drafted its own reform package. "The board wanted to do something to extend that margin."

Those PERA proposals are now reflected in Senate Bill 174 by Sen. Paula Sandoval, D-Denver. Like the rival plan crafted by Owen, it includes a "two-tier" pension plan that would offer employees hired after Jan. 1, 2007, overall benefits about 19 percent less generous than those given guaranteed current employees or retirees.

Additionally, new workers will not receive guaranteed cost-of-living increases. Current or retired employees are guaranteed a 3.5 percent increase in benefits each year. In partial compensation for their lower benefits, future employees would contribute only 7 percent of their pay to PERA, compared with the 8 percent current members contribute. Employer contributions, now at 10.15 percent of employee salaries and scheduled to rise to 13.15 percent by 2012, would be increased another .5 percent, to 13.65 by 2012.

Unlike Owen's proposal, the PERA plan would place the entire burden of stabilizing the system to new hires and higher employer contributions - with no cuts in pension benefits for retirees and no increases in contributions by current employees .

In excluding any cuts for current retirees and slashing benefits for new hires, PERA and its critics agree on what might be called the "five minute rule." PERA members who are already retired - even if they left just five minutes ago - are considered "fully vested" and thus legally immune from any changes that would reduce their current or future benefits. In contrast, all analysts agree the state is free to change the benefits of future employees - even those hired five minutes from now - because those future hires do not yet have a legal stake in the retirement program.

Where PERA and its critics part company is over whether the 188,744 public employees still working in PERA-covered jobs can be asked to accept less generous pension benefits accrued in the future years they will work before retiring - and whether existing employees can be asked to pay part of the cost of stabilizing their current benefits.

PERA itself argues that the law bans any adverse change affecting even future earned benefits for existing employees. But a 2004 opinion by then-Attorney General Ken Salazar says the legislature can give existing employees less generous benefits for future years of service and increase the amount they contribute to their retirement plan if such a change is "actuarially necessary" to ensure that PERA doesn't eventually run out of money to pay its obligations.

Owen is relying on that ruling by proposing to increase the pension contributions of existing employees by 3 percent. For their part, while officially resisting any cuts or contribution increases that would affect current employees, PERA's trustees and other employee groups are negotiating earnestly with legislative leaders, including Rep. Bernie Buescher, D-Grand Junction. Buescher has been meeting with various players in the PERA game and may try to craft a compromise measure incorporating ideas from both Sandoval and Owen.

One reason employee groups are willing to consider a compromise plan is because Rep. Joe Stengel, R-Littleton, earlier introduced a bill shifting all future hires to 401(k)-style defined contribution plans. While the bill died, the Americans for Prosperity Foundation is considering putting it on the November ballot by citizen initiative. Most employee groups are militantly opposed to a shift to defined contribution plans - especially since many PERA employees lack the Social Security benefits that supplement 401(k) plans in the private sector.

One final issue that is still unresolved is what to do about the PERA board itself. The board of trustees now has 14 members elected by PERA members or retirees, plus the state treasurer and state auditor. Gov. Bill Owens has threatened to veto any bill that doesn't add taxpayer representatives to the board. But if legislators can resolve the tough financial issues necessary to ensure the state can meet its future pension obligations for public employees, the question of reshuffling the PERA board shouldn't stop them from passing reform legislation this year.